SUPREME COURT, U. S.

No. 74-796

Supreme Court, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1974

WOODSTOCK, INC.,

Petitioner,

vs.

NICHOLAS A. KARRIS,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ILLINOIS

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF ILLINOIS

Petitioner, Woodstock, Inc., appellant in the court below prays that a writ of certiorari issue to review the judgment of the Appellate Court of Illinois, Petition for Leave to Appeal to the Supreme Court of Illinois having been denied.

Opinion Below

The opinion of the Appellate Court of Illinois, First Judicial District, reported at 19 Ill. App. 3d 1, 312 N.E. 2d 426 (1974) is appended hereto as Exhibit A. The Appellate Court's Supplemental Opinion, reported at 19 Ill. App. 3d 1, 12, 312 N.E. 2d 426, 434 (1974) is appended hereto as Exhibit B.

Jurisdiction

The Appellate Court of Illinois, First Judicial District, in an opinion dated January 18, 1974, upheld the judgment of the trial court. Petitioner's petition for rehearing was denied in an opinion dated May 17, 1974. Petitioner's Petition for Leave to Appeal was denied by the Supreme Court of Illinois on September 27, 1974. (Exhibit C) This petition was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

Questions Presented

I. A substantial question is presented as to whether petitioner was denied its rights, privileges and immunities as a commodity broker under Title 7, § 1 et seq. of the United States Code.

II. When petitioner is denied the right to adduce competent evidence on crucial facts in issue, are petitioner's rights violated under the Fourteenth Amendment to the United States Constitution?

Constitutional and Statutory Provisions Involved

The Fourteenth Amendment of the United States Constitution provides in part:

> ". . . nor shall any State deprive any person of life, liberty or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

Section 4 of Title 7 of the United States Code (§2(a), 42 Stat. 998) provides:

> "For the purpose of this chapter the act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corpora-

tion, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person."

Section 5 of Title 7 of the United States Code (§ 3, 42 Stat. 999) provides:

"Transactions in commodity involving the sale thereof for future delivery as commonly conducted on boards of trade and known as 'futures' are affected with a national public interest; such transactions are carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodity and the products and byproducts thereof in interstate commerce; the prices involved in such transactions are generally quoted and disseminated throughout the United States and in foreign countries as a basis for determining the prices to the producer and the consumer of commodity and the products and byproducts thereof and to facilitate the movements thereof in interstate commerce; such transactions are utilized by shippers, dealers, millers, and others engaged in handling commodity and the products and byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price; the transactions and prices of commodity on such boards of trade are susceptible to speculation, manipulation, and control, and sudden or unreasonable fluctuations in the prices thereof frequently occur as a result of such speculation, manipulation, or control, which are detrimental to the producer or the consumer and the persons handling commodity and products and byproducts thereof in interstate commerce, and such fluctuations in prices are an obstruction to and a burden upon interstate commerce in commodity and the products and byproducts thereof and render regulations imperative for the protection of such commerce and the national public interest therein."

Section 6d of Title 7 of the United States Code (§ 6, 82 Stat. 27) provides in part:

> "It shall be unlawful for any person to engage as futures commission merchant in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contracts of sale of any commodity for future delivery, on or subject to the rules of any contract market unless—
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> • • •
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> (2) such person shall, whether a member or nonmember of a contract market, treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. . . ."
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> "It shall be unlawful for any person, including but not limited to any clearing agency of a contract market and any depository, that has received any money, securities, or property for deposit in a separate account as provided in paragraph (2) of this section, to hold, dispose of, or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the customers of such futures commission merchant."

TABLE OF AUTHORITIES

A. *Cases*

In re Murchison, 349 U.S. 133 (1955)

Benedict v. *Dakin*, 243 Ill. 384 (1909)

Creighton v. *Elgin*, 387 Ill. 592 (1944)

Gass v. *Carducci*, 37 Ill. App. 2d 181 (1962)

Giddings v. *Williams*, 336 Ill. 482 (1929)

John v. *Tribune Company*, 28 Ill. App. 2d 300, *rev'd on other grounds*, 24 Ill. 2d 437 (1960)

Klatt v. *Commonwealth Edison Co.*, 33 Ill. 2d 481 (1965)

Libre v. *Brotherhood of Amer. Yeomen*, 168 Ill. App. 328 (1912)

People v. *Nichols*, 378 Ill. 487 (1941)

Towne v. *Towne*, 191 Ill. 478 (1901)

Underwood v. *Penn. R. Co.*, 34 Ill. 2d 367 (1966)

B. *Texts, Treatises*

McCormick on Evidence (2d ed. 1972)

Restatement (Second) of Agency (1958)

Wigmore on Evidence (3rd ed. 1940)

Statement of Proceedings

This action was brought to recover a deposit made with the petitioner for a commodity transaction which plaintiff-respondent claimed was unauthorized. Petitioner claimed the transaction was authorized by the respondent and brought a counterclaim for losses it sustained in connection with the transaction. The matter was tried without a jury and at the conclusion the trial judge entered judgment in favor of the respondent and dismissed petitioner's counterclaim.

The Appellate Court of Illinois, First Judicial District, in an opinion dated January 18, 1974, upheld the judgment of the trial court. Petitioner's petition for rehearing was denied in an opinion dated May 17, 1974. Petitioner's Petition for Leave to Appeal was denied by the Supreme Court of Illinois on September 27, 1974.

Statement of Facts

The facts, as reflected in the opinion of the Illinois Appellate Court are substantially as follows:

Respondent placed a number of commodity trades through Martin Scanlon, who at the time of the events in issue was employed as a broker by petitioner, Woodstock, Inc. *Karris* v. *Woodstock, Inc.*, 19 Ill. App. 3rd, 1, 3, 312 N.E.2d 426, 427 (1974).

On December 23, 1969, respondent verbally authorized the purchase of pork belly futures through Scanlon. Respondent realized a $56,505.00 profit on his December 23 trades. He gave $16,000 of this profit to Scanlon. *Id.*

On March 17, 1970, respondent deposited $50,000 in a trading account with Woodstock, Inc. A government quarterly report on pork bellies was to be issued after the close of trading on March 20. On March 20, orders were placed for respondent's account which resulted in the loss of his $50,000 deposit and a loss of $23,920 in excess of the deposit. The quarterly report had had an unfavorable effect on the market. 19 Ill. App. 3rd at 3-5, 312 N.E.2d at 428-29.

The central factual issue in this case was whether the trades which Martin Scanlon placed for respondent Karris' account on March 20 were authorized by Karris. There was testimony from respondent to the effect that he had not authorized the trades, and that he did not learn of the trades until after the close of trading on March 20, 1970. After the close of trading, and after the issuance of the government report, respondent disavowed the trades which were placed for his account on March 20. He testified that he had not authorized the trades, and did not learn of them until he called petitioner's office in Kansas City to arrange for a refund of his $50,000 deposit. 19 Ill. App. 3rd at 4-5, 312 N.E.2d at 428-29.

Scanlon's deposition testimony was that he thought that he and respondent were "in concert" to get long on the market, and that he had placed the orders for respondent's account without specific authorization from respondent. He testified that, contrary to his past practice, and despite the fact that he held several phone conversations with the respondent during trading hours, he did not advise respondent during trading hours that orders had been placed for his account and filled. 19 Ill. App. 3rd at 3-4, 312 N.E.2d at 427-28.

Richard Becker, petitioner Woodstock's vice president, who administrates the functions of the company, testified for petitioner that he had had several conversations with respondent during trading hours on March 20. He further testified that he had discussed with respondent the orders which had been placed and were being filled for respondent's account. 19 Ill. App. 3rd at 7-8, 312 N.E.2d at 430-31.

In short, there was conflicting testimony on the central question of whether respondent had authorized the trades and was aware during the course of trading on March 20 that orders were being filled for his account.

Peter Stavros was the supervisor of all petitioner's activities on the floor of the Mercantile Exchange. Scanlon placed orders with him for Scanlon's customers. On March 20, he received orders from Scanlon for Karris' account, and reported back to Scanlon as the orders were filled.

By offer of proof, Stavros stated that on March 20, 1970, prior to the close of trading, he overheard a telephone conversation between Scanlon and Karris. He further stated that during the course of that conversation Scanlon advised Karris that orders had been placed for his account and were being filled. The trial court ruled that the testimony offered by Stavros was inadmissible hearsay. The Appellate Court upheld this ruling. 19 Ill. App. 3rd at 11, 312 N.E. 2d at 433.

REASONS FOR GRANTING THE WRIT

I.

A SUBSTANTIAL QUESTION IS PRESENTED AS TO WHETHER PETITIONER WAS DENIED ITS RIGHTS, PRIVILEGES AND IMMUNITIES AS A COMMODITY BROKER UNDER TITLE 7, § 1 ET SEQ. OF THE UNITED STATES CODE.

The central factual issue in this case was whether the trades that Martin Scanlon, petitioner's employee, placed for his customer, the respondent, were authorized. By his complaint Karris alleged that petitioner Woodstock had violated its duties to respondent arising under the Commodity Exchange Act, 7 U.S.C. § 1 et seq. (Compl. ¶¶ 1 & 3). By Answer and Counterclaim, petitioner admitted being subject to the Commodity Exchange Act as a commodity broker, but denied in any way violating its duties under the Commodity Exchange Act (Ans. ¶¶ 1 & 3). After hearing conflicting testimony on the lawfulness of the authorization for the trades in issue, the trial court found that the trades were not authorized by the respondent. The appellate courts of Illinois upheld this finding, and held that Scanlon was therefore acting as petitioner's agent in placing the trades. Even assuming that respondent had not authorized the trades and that Scanlon was petitioner's agent, the courts below failed to recognize the importance of going beyond this issue to the issue of whether Scanlon acted within the scope of his employment. This latter issue must now be examined and decided under § 4 of 7 U.S.C., § 1 et seq., the Commodity Exchange Act, which requires that petitioner not be held liable for the acts of its agent unless those acts were performed within the scope of his employment.

In particular, § 4 of the Commodity Exchange Act provides as follows:

> "For the purpose of this chapter the act, omission or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent or other person."

In providing for regulation of the futures market, Congress in the above section recognized that it was necessary to protect customers in the futures market by providing that the acts of employees of exchange members would be deemed the acts of the members in some circumstances. Congress also recognized the necessity of protecting members of the commodities exchanges against the imposition of unwarranted and absolute liability for the acts of anyone employed by them. Both of these congressional policies are embodied in the language of § 4 of the Act.

In the instant case, the decisions below hold that Scanlon, the broker, was an agent of petitioner, and conclude from that that Scanlon was acting within the scope of his employment in placing the orders for futures contracts on March 20. The Illinois Appellate Court justified this conclusion with the statement that:

> "The executing of orders was defendant's [Petitioner's] basic function. Defendant [Petitioner] presented proof that a commission charge of $2700 would be due from the alleged transaction. This demonstrates that Scanlon was directly advancing defendant's interests." 19 Ill. App. 3d 1, 13, 312 N.E. 2d 426, 435 (1974).

Section 6d of the Act provides in part that:

> "It shall be unlawful for any person to engage as futures commission merchant in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contracts of sale of any commodity for future delivery, on or subject to the rules of any contract market unless—
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> "(2) such person shall, whether a member or nonmember of a contract market, treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. . . ."
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> "It shall be unlawful for any person, including but not limited to any clearing agency of a contract market and any depository, that has received any money, securities, or property for deposit in a separate account as provided in paragraph (2) of this section, to hold, dispose of, or use any such money, securities or property as belonging to the depositing futures commission merchant or any person other than the customers of such futures commission merchant."

A violation of this provision carries with it the penalties provided for in § 13(c) of the Act which reads as follows:

> "Except as provided in paragraphs (a) and (b) of this section, it shall be a misdemeanor punishable by a fine of not more than $10,000 or imprisonment for not more than one year, or both, together with the costs of prosecution, for any person to violate the provisions of sections 6-6e, 6h, 6i or 12b of this title, or to fail to evidence any contract mentioned in section 6 of this title by a record in writing as therein required."

The finding below that Scanlon acted without authority in placing the trades suggests a violation by Scanlon of these provisions of the Act. Yet the decision below concludes that this conduct was within the scope of Scanlon's employment. Petitioner specifically requested a hearing on appeal on this issue, but it was denied.

Whether the conduct involved in the present case—conduct which is specifically prohibited by the Commodity Commodity Exchange Act and conduct which might in some circumstances constitute a criminal violation of the Act—is "within the scope of employment" of an exchange member's agent is a question which has not been presented to the federal courts. As of this writing, no federal cases have been discovered which have decided this question. The question must be decided in light of the congressional purposes embodied in section 4 of the Act and not in the conclusory manner in which it was decided in the courts below.

The decisions below appear to be based on the assumption that since a loss has been incurred, and must be borne by someone, it should fall on the petitioner whose agent's unauthorized conduct resulted in the loss. The court below proceeded on an either/or assumption as to who should bear the loss. It ignored the congressional policy embodied in § 4 of the Act that an exchange member's liability for the acts of its agent is limited to acts done within the scope of his employment. Where, as here, the act was outside the scope of his employment, the loss should be borne, as Congress intended, by the agent.

The standard which should govern the determination, under section 4 of the Commodity Exchange Act, of whether an agent's act is within the scope of his employment, is the standard which petitioner argued below. When, as

here, the agent acts in gross defiance of his principal's rules, and is aware that his activities exceed the scope of his authority, his act is not within the scope of his employment. *Restatement (Second) of Agency* § 235 (1958). The decision below, by failing to apply this standard, imposes liability on petitioner despite the limitation of liability contained in Section 4 of the Commodity Exchange Act.

Petitioner contended below, and it was not contested, that it had fully complied with the rules of the Chicago Mercantile Exchange and the requirements of the Commodity Exchange Act. Yet, the decisions below deny petitioner the protections Congress afforded it under the Act, notwithstanding that petitioner has complied with the rules of the Exchange and the requirements of the Act.

The result reached below, if permitted to stand, would have a serious and disruptive effect on the conduct of business in the futures markets. It is well recognized that the overwhelming majority of orders placed by customers in the futures markets are oral and not written, and, like other markets, such as the securities markets, millions of dollars of obligations are entered into daily on the basis of verbal communications between brokers and buyers or sellers. Particularly in the commodity market, in which small changes in price in a margin transaction are multiplied several times in magnitude, speed of execution in buying or selling is essential to the maintenance of an orderly market. A broker must rely on his customer in forwarding an oral order for execution; the customer must rely on the broker to cause an oral order to be executed. If, as in the instant case, the exchange member must bear the loss when a broker acts without authority, or when an authorized contract is repudiated by a customer, the ability of those involved in the market to rely on the integrity of oral orders is jeopardized.

In the instant case respondent maintained with petitioner the type of account in which trades could only be made if specifically authorized by the customer. If the loss for unauthorized trading by an agent is to fall on his employer, even though the trading is in violation of the Commodity Exchange Act and/or outside the scope of the agent's employment, exchange members might feel compelled to protect themselves by requiring written authorization before trades will be made for this type of account. If exchange members attempt to protect themselves in this manner against the imposition of a liability which Congress did not intend, the orderly functioning of the futures markets will be disrupted by the delays ensuing therefrom.

Surely such a result was not intended by Congress and further illustrates the fatal error of the courts below in this case: they failed to correctly apply the standards of agency set forth in § 4 of the Commodity Exchange Act. By failing to apply these standards, the state courts have deprived Petitioner of the rights, privileges and immunities granted to it by Congress under the Commodity Exchange Act.

II.

WHEN PETITIONER IS DENIED THE RIGHT TO ADDUCE COMPETENT EVIDENCE ON CRUCIAL FACTS IN ISSUE, ARE PETITIONER'S RIGHTS VIOLATED UNDER THE FOURTEENTH AMENDMENT TO THE UNITED STATES CONSTITUTION?

Karris repeatedly testified at trial that he did not learn that orders had been placed for his account until after the close of trading on March 20, 1970. Martin Scanlon testified that he had not advised respondent during trading hours of the fact that orders were being filled for his account. Stavros' testimony, if admitted, would have directly

contradicted both the respondent and Martin Scanlon on this crucial factual issue.

Hearsay evidence is testimony of a statement made out of court, the statement being offered as an assertion to show the truth of the matters asserted therein, and thus resting for its value upon the credibility of the out-of-court asserter. McCormick on Evidence (2d ed. 1972) §246, p. 584. *Gass* v. *Carducci,* 37 Ill. App.2d 181, 187 (1962). As is apparent from the definition, the hearsay rule does not apply when an out-of-court statement is used not as evidence of the fact asserted but as circumstantial evidence for another purpose. 6 Wigmore on Evidence, §§ 1788-1789 (3rd ed. 1940). *Gass* v. *Carducci,* 37 Ill. App. 2d 181, 187-188 (1962). When knowledge or belief is one of the issues on the trial, a declaration made by the person in question or by others may constitute circumstantial evidence bearing on the issues and the hearsay rule would have no application. *John* v. *Tribune Company,* 28 Ill. App.2d 300, 313; *Towne* v. *Towne,* 191 Ill. 478 (1901); *Benedict* v. *Dakin,* 243 Ill. 384 (1909); *People* v. *Nichols,* 378 Ill. 487 (1941).

In *Gass* v. *Carducci, supra,* an automobile repairman was allowed to testify concerning statements made to him by the defendant's husband which indicated that the husband was aware of the defective condition of a door lock prior to an accident. The statements were offered to establish not the defectiveness of the lock, but defendant's awareness of the defect. Stavros' testimony, like the testimony of the repairman in *Gass,* was offered not for the purpose of establishing the truth of any of the statements which he had overheard, but solely for the purpose of establishing that a conversation had taken place between Karris and Scanlon and that in the course of that conversation, Kar-

ris had been advised by Scanlon that orders had been placed for Karris' account and filled. The witness had firsthand knowledge of this conversation and was competent to testify to its content.

The testimony was offered to establish the crucial fact of Karris' awareness during the course of trading that orders had been placed for his account. On this issue, the testimony was not hearsay but was admissible substantive evidence on this crucial question. Thus, the trial court erred in characterizing Stavros' testimony as inadmissible hearsay.

As a general rule, the exclusion of competent, material evidence on a question in issue is reversible error. *Creighton* v. *Elgin,* 387 Ill. 592 (1944); *Underwood* v. *Penn. R. Co.,* 34 Ill. 2d 367 (1966); *Klatt* v. *Commonwealth Edison Co.,* 33 Ill.2d 481 (1965); *Giddings* v. *Williams,* 336 Ill. 482 (1929). This is particularly true where the issue was closely contested. *Libre* v. *Brotherhood of Amer. Yeomen,* 168 Ill. App. 328 (1912).

Under these circumstances, and in light of the importance of Stavros' testimony to the trial of this matter, the trial court's exclusion of Stavros' testimony denied petitioner the due process of law guaranteed by the 14th Amendment to the United States Constitution. *In re Murchison,* 349 U.S. 133, 136 (1955).

CONCLUSION

Petitioner respectfully prays that a Writ of Certiorari issue to review the substantial federal questions presented herein.

Respectfully submitted,

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